

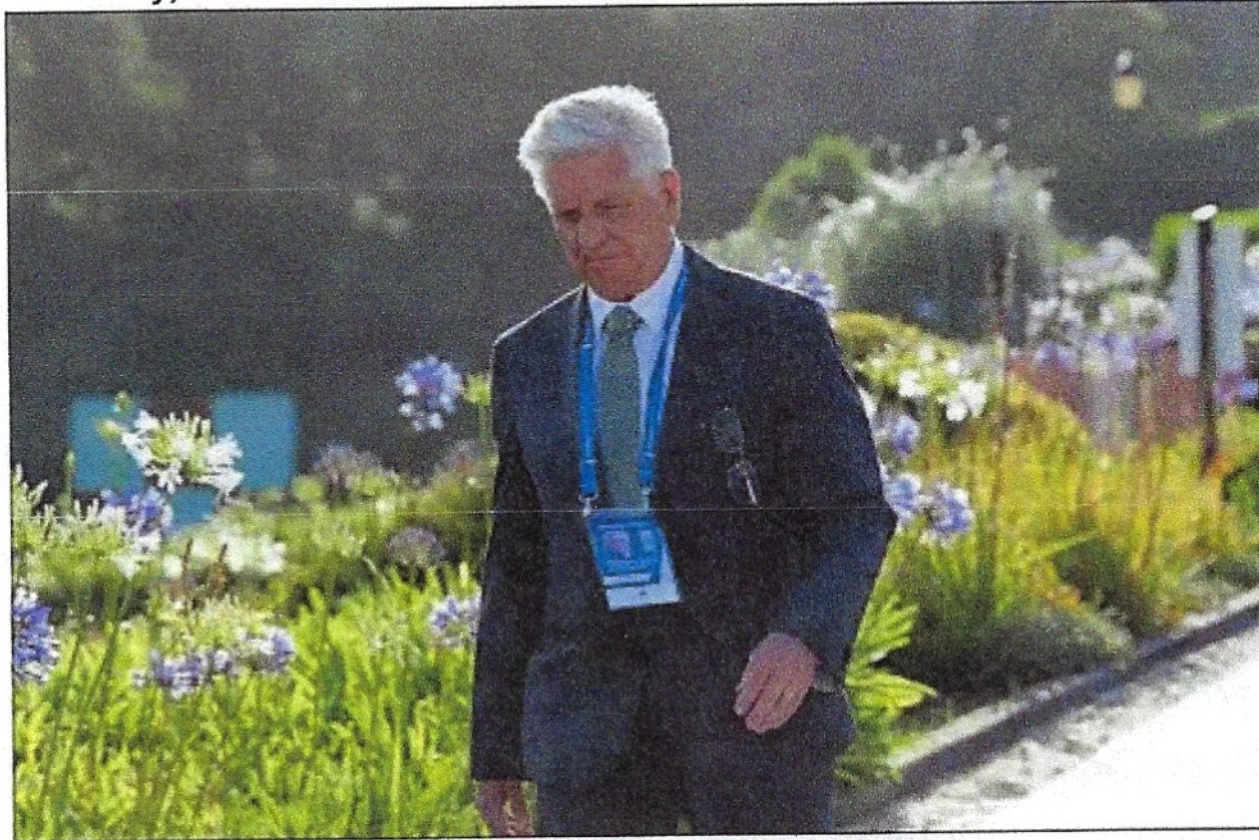
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Fed: Rate hike may be needed if inflation stays hot

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NEW YORK · The U.S. central bank may need to raise interest rates “in the near term” if coming data show inflation continuing well above the 2% target, Federal Reserve Governor Christopher Waller said Monday, in remarks that characterized monetary policy as being at a “crossroads.”



Waller told the New York Association for Business Economics that he'll be leaning heavily on inflation data, starting with a consumer price index report on Tuesday, noting that the Fed should not be “lackadaisical” if the data break in the wrong direction.

“Sternly staring at inflation until it melts before our withering gaze is not an option,” Waller said, winning a chuckle from the room of economists gathered for his speech.

“We’re building off of basically almost, you know, five to six months of ‘higher, higher, higher, higher,’ on inflation readings,” Waller said. “If I get another higher one, I’m going to treat that as signal, not noise.”

He spoke amid the resumption of military conflict between the U.S. and Iran, which is already pushing oil prices higher again.

“There is still a credible case for inflation to begin to fall back to our 2% goal with policy at its current setting. But I am concerned about the equally plausible case that data in the coming weeks will show that inflation will remain at its elevated level or even trend higher, requiring tighter monetary policy in the near term,” Waller said.

In particular, he said he is worried that recent inflation reports have shown price pressures seeming to broaden throughout the economy, beyond the influence of last year’s import tariff increases or the recent jump in energy costs and potentially reflecting more systemic inflation that would require

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tighter monetary policy. Of the categories in core services, which account for 75% of core prices, nearly 70% have three-month and 12-month inflation over 3%, he said.

While the situation is not comparable to the breakout of price increases that followed the COVID-19 pandemic, with the labor market not as tight, for example, Waller said the Fed has the benefit of anchored inflation expectations — an advantage the policy-setting Federal Open Market Committee should not squander by waiting too long to raise rates if inflation persists.

“I don’t take the inflationary signals I have discussed today lightly. If we get another hot reading on core inflation this week, then the FOMC will need to consider tightening monetary policy in the near term,” Waller said. He added that it would take “several months of lower readings to feel that inflation is finally moving in the right direction.”

Financial markets are pricing about a 40% chance of a policy-rate increase at the Fed’s July meeting, and overwhelming odds of a rate hike by September.

While Waller said he does not want to raise rates prematurely and risk a recession, he regards the job market as stable and feels the Fed needs to avoid making the mistake of several years ago by waiting too long to respond to rising price pressures.

The Fed held interest rates steady at its June 16-17 meeting, with policymakers evenly divided at that point over the likely need for a rate increase this year.

Waller’s blunt portrayal of the Fed’s next move as hinging on this week’s inflation data contrasts with the communications approach of new Fed Chairman Kevin Warsh, who has studiously avoided giving away much if anything on his own “reaction function.”

“You want the markets to have as much information as possible,” Waller said on Monday. “Surprising people is not a good idea.”

Waller said he feels the Fed will learn a lot from the five task forces Warsh has created to come up with recommendations on revamping the Fed’s approach to monetary policy, even as he put forward a few of his own ideas, including shortening the timeframe of Fed policymaker projections to 18 months from three years currently, and publishing them a day later than current practice.

On the balance sheet, which Warsh has said he wants to shrink, Waller said he doesn’t see any harm in the Fed’s big balance sheet, though wishes it could be all-Treasuries as it was before the Fed began buying mortgage-backed securities in the 2007-2009 financial crisis.

“I don’t know how we’re ever — it’s going to take us another decade to get rid of these things running off. You know, maybe we can do an asset swap for Greenland or something, I don’t know,” he joked.

On inflation, yet another task force topic, he rejected the idea of abandoning a numeric target altogether. “In that world, you know, inflation becomes like pornography — I can’t define it, I can’t measure it, but I know it when I see it — and that’s not how central bankers should think about inflation,” he said.

But targeting an inflation range of, say, 1.5%-2.5% would be “a reasonable way to proceed.” Warsh has indicated he too might prefer a range, saying he is focused on the number “to the left of the decimal point.”

Asked which task force he would like to run if he could, Waller demurred, nodding to Warsh’s stated ambition of overhauling the Fed.

"If you're doing regime change, you don't ask the current regime to be running the task force," Waller said.

